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BEFORE THE

PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

FILED

2007 SEP 19 P 3:59

PUBLIC UTILITIES COMMISSION

In the Matter of the Application of	)	
	)	
HAWAIIAN ELECTRIC COMPANY, INC.	)	DOCKET NO. 2006-0386
	)	
For Approval of Rate Increases and	)	
Revised Rate Schedules and Rules	)	
	)	

DEPARTMENT OF DEFENSE'S RESPONSES TO
HAWAIIAN ELECTRIC COMPANY, INC'S. INFORMATION REQUESTS
AS TO PENSION ASSET ISSUE

Pursuant to the Stipulated Settlement Letter filed by the Parties on September 6, 2007, the Department of Defense ("DOD") submits its RESPONSES TO HAWAIIAN ELECTRIC COMPANY, INC'S. INFORMATION REQUESTS AS TO PENSION ASSET ISSUE in the above docketed matter. DOD's Ralph Smith prepared all responses and would sponsor them at any evidentiary hearing.

DATED: Honolulu, Hawaii, September 19, 2007.

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DOCKET NO. 2006-0386

DEPARTMENT OF DEFENSE'S RESPONSES TO HAWAIIAN ELECTRIC COMPANY, INC'S. INFORMATION REQUESTS AS TO PENSION ASSET ISSUE

HECO/DOD-IR-101

Ref: DOD-108

In each rate case, a portion of the test year NPPC is transferred to plant and, therefore, is not included in test year expenses. What is the basis for including the amount of NPPC transferred to plant in total "NPPC in rates" (col. C)?

RESPONSE: Assuming that the request was attempting to refer to the "Included In HECO Rates" information on DOD-108, page 2, Column F, the purpose of presenting that information is to make an "apples to apples" comparison with the information in columns B and C, on that page, which show, respectively, the "FAS 87 Accrual" and "Trust Contribution" amounts for each year. Exhibit DOD-108, page 2, compares 100% of the recorded NPPC with 100% of the pension funding payments that HECO made into the pension trust. It is appropriate to compare 100% of the recorded NPPC with 100% of the pension funding payments that HECO made into the pension trust because the pension asset balance recorded by HECO does not apportion the NPPC between the capitalized portion and the portion of NPPC charged to O&M expense. The purpose of the information shown on Exhibit DOD-108, page 2, is to present the difference between the NPPC actually recorded by HECO, which has influenced the level of HECO's pension asset balance, and the NPPC included in rates and paid by ratepayers since Statement of Financial Accounting Standards No. 87 ("SFAS 87") was adopted. The analysis shown on DOD-108, page 2, shows that through December 31, 2007 a net amount was provided to HECO by ratepayers for pensions of $46,915,617. This analysis demonstrates that, based on the specific facts of HECO's situation, ratepayers have effectively provided HECO with approximately $46.9 million more for NPPC included in rates than HECO has contributed into the pension trust. DOD-108, page 2, thus demonstrates how inequitable it would be to ratepayers if HECO's request to include a pension asset in rate base of $59.4 million (based on the average for 2007, see DOD-108, page 2, column E, line 21) were to be granted.

HECO/DOD-IR-102 Ref: DOD T-1, pages 8-12

a) Is it the DOD's position that ratepayers have funded the "pension asset" claimed by HECO?

b) If the response to (a) is yes, please explain how ratepayers have provided the funds.

c) Is it the DOD's position that amounts contributed to the Pension Fund in excess of the NPPC amount (in years in which the NPPC was positive) were funded by ratepayers? If yes, please explain?

d) Does the DOD agree that contributions made to the Pension Fund that are in excess of the NPPC result in a lower NPPC in future years (than if only NPPC had been contributed)? If no, please explain.

e) Is it the DOD's position that HECO's rates set in HECO's 1995 rate case were too high during the period from 1996 to 2005, and should have been reduced to reflect the decrease in NPPC from the estimate used in determining revenue requirements in the 1995 test year rate case?

f) Did the DOD review HECO's filed results of operations following any of the years in which HECO's NPPC was negative (1999-2002, 2004), and assess or make a determination as to whether HECO's rates should be reduced or a rate investigation should be initiated? Please explain.

g) Is the DOD aware of a ratemaking process in Hawaii pursuant to which a utility can request that its rates be kept the same, but that the components of revenue requirements (including NPPC, net of transfers) be reset to reflect current conditions? If yes, please explain.

RESPONSE:

a) DOD's position is that the analysis on DOD-108, page 2, as well as the similar analysis presented by CA in this proceeding shows that ratepayers have provided through payment of rates more than sufficient funds to cover the amount of HECO's claimed pension asset, consequently, it would be inappropriate and highly inequitable to ratepayers to include such a pension asset in rate base. The pension asset that HECO is seeking to include in rate base results from the amount of cumulative payments into the pension trust in excess of the cumulative NPPC that was recorded by the Company. Moreover, virtually the entire pension asset that HECO seeks to include in rate base is attributable to years in which HECO recorded negative NPPC, and those negative amounts of NPPC recorded by HECO in those years were never recognized in a test year for ratemaking purposes. Finally, it must be recognized that ratepayers have provided to HECO the amount of NPPC included in rates, not the amount of NPPC recorded by HECO in years when there were no rate cases and no test years to capture the NPPC for the benefit of ratepayers. Because of the annual fluctuations in the annual amounts of NPPC recorded by HECO and the infrequency of rate cases between 1991 and 2005, the rates charged to ratepayers by HECO over the years have more than adequately compensated HECO for pension costs and, given this factual situation, which is detailed on Exhibit DOD-108, page 2, it would be highly unreasonable, inappropriate and unfair to ratepayers to include any portion of the $59.4 million pension asset requested by HECO in rate base.

b) Ratepayers have provided funds through payment of rates which have included pension cost as shown on DOD-108, page 2. See response to part a for further explanation.

c) No. The cash contributions to the pension trust fund shown on DOD-108, page 2, in column C were funded by HECO; however, the amounts of HECO funding are significantly less than the NPPC included in rates; consequently, under such a situation, it would be inequitable to charge ratepayers for a return on a pension asset and the pension asset should not be included in rate base. Since 1995 when the NPPC under SFAS 87 was recognized for HECO ratemaking purposes by this Commission, as shown on DOD-108, page 2, the cumulative amount of NPPC included in HECO's utility rates of $98,286,000 has significantly exceeded the cumulative amount of HECO's contributions to the pension fund of $49,634,955. The amount of NPPC in rates for the period 1996 through 2007 of $98,286,000 exceeds HECO's contributions into the pension trust fund of $49,634,955 by $ 48,651,045.

d) Not necessarily. Pension funding between the minimum required amounts and the maximum tax deductible amounts is discretionary with HECO management and is the amount of actual funding payments into the pension trust for a year. It is not dependent upon the NPPC in that year as illustrated in 2006, HECO had a $14,237,000 FAS 87 accrual but made no funding payment into the pension trust. Higher pension funding would generally result in higher pension trust assets, which could in turn result in pension trust earnings, which would tend to reduce the FAS 87 amount, all other things being equal; however, there are number of other factors which impact the NPPC, so the pension expense wouldn't necessarily be lower in a future year. As an illustrative example, in 2005, HECO had an NPPC of $4,588,000 and funded $6 million into the pension trust; however, the NPPC <u>increased</u> to $14,237,000 in 2006 and to $17,711,000 in 2007.

e) No. It is DOD's position that the pension asset should be excluded from rate base in the current case. See response to part a, above, for further explanation.

f) No it did not.

g) DOD's understanding of the ratemaking process is that HECO's rates remain in effect until they are re-established in a subsequent ratemaking proceeding. DOD is not aware of any prohibition that would prevent HECO from filing a rate case every year if HECO management felt that was necessary. As a practical matter, HECO does not have to file a request "that its rates be kept the same," rather, it achieves this result by the "ratemaking process" of <u>not</u> filing for rate changes.

HECO/DOD-IR-103 Ref: DOD T-1, Page 24

The testimony states that "The ADIT for 'AFUDC on CWIP' represents cost-free capital recorded on the utility's books that should be recognized in the ratemaking process. There are generally two ways to recognize such ADIT: 1) by reducing rate base for such ADIT, or 2) by reducing the CWIP investment base, upon which AFUDC is accrued for such ADIT." Please describe more fully what is meant by alternative 2), and what is entailed, from an accounting and ratemaking perspective, in "reducing the CWIP investment base," in light of the fact that CWIP is not included in rate base.

RESPONSE: The ADIT related to "AFUDC on CWIP" is recorded on the HECO's books in a deferred credit account. CWIP is not included in rate base, but does earn an AFUDC return, which HECO calculates by applying an AFUDC rate to a balance of CWIP (that has been referred to as the "CWIP investment base for AFUDC," or similar terminology). From an accounting perspective, reducing the CWIP investment base upon which AFUDC is accrued for the ADIT would be one way to recognize and reflect the ADIT. However, since HECO does not do that, reflecting the ADIT as a reduction to rate base, as DOD witness Smith has recommended, should be done to assure that the ADIT is appropriately reflected in the ratemaking process. HECO's proposal essentially ignores the ADIT by (1) not reflecting it in the AFUDC calculation and (2) not reflecting it as a rate base reduction. For purposes of illustrating the concept, assume that HECO had $10 million of CWIP and $1 million of ADIT for AFUDC on CWIP. HECO accrues additional AFUDC on the $10 million. In calculating AFUDC, HECO has stated that it does not reduce the $10 million of CWIP by the $1 million of ADIT.

For illustrative purposes, if an 8% AFUDC rate were used, HECO would record $800,000 of AFUDC. HECO would ultimately charge that AFUDC to ratepayers by including it in plant and depreciating it. If the CWIP balance for AFUDC were reduced by the related ADIT, the balance for AFUDC would be $9 million ($10 million CWIP less $1 million ADIT), and the AFUDC at 8% would be $720,000. Since HECO ignores the $1 million ADIT in its calculation of the AFUDC, the AFUDC computed is higher ($800,000 versus $720,000 in this illustrative example). Under alternative 2, the AFUDC would be $720,000 or approximately $80,000 less than the way HECO calculates it (which reflects no reduction to the CWIP balance for AFUDC for the related ADIT). By reflecting the ADIT as a deduction to rate base (alternative 1), the $1 million is recognized in the ratemaking process. The reduction of $80,000 ($1 million x 8%, assuming for simplicity that the same return is used for AFUDC and on rate base), maintains regulatory equity by recognizing the piece that is missing or ignored in HECO's AFUDC calculation (i.e., the difference between the $800,000 versus $720,000 AFUDC amounts in this illustrative example).

HECO/DOD-IR-104 Ref: DOD T-1, Exhibit DOD-101, page 2 (Adjusted Rate Base).

Presented on line 10 in the reference exhibit is an adjusted rate base balance of $1,152,596,000.

Please reconcile and describe the difference in this adjusted rate base balance and the adjusted rate base balance presented in DOD-103, Column C, line 23 of $1,150,720,000.

Please confirm what is the adjusted rate base balance utilized and presented by the DOD in this testimony.

RESPONSE:

a. DOD's proposed rate base is $1,150,720,000 as shown on DOD-103, Column C, line 23, and DOD-101, page 1, column B, line 1. The difference of $1.876 million relates to HECO's originally filed rate base before and after adjustment for cash working capital at proposed rates, as summarized below (from DOD-103, Column A, lines 21-23). The difference is shown on line 22 of that exhibit:

Hawaiian Electric Company, Inc. DOD-103
Adjusted Rate Base Docket No. 2006-0386
Test Year Ending December 31, 2007 Page 1 of 1

Line No.	Description		HECO As Filed (A)
21	Rate Base at Present Rates	$	1,216,188
22	Working Cash (at proposed rates)	$	(1,876)
23	**Rate Base at Proposed Rates**	$	1,214,312

If the $1,214,312 HECO amount for Rate Base at Proposed Rates listed above is used as the starting point for the rate base reconciliation on DOD-101, page 2, line 2, the reconciled rate base on DOD-101, page 2, line 10, equals the $1,150,720,000 as shown on DOD-103, Column C, line 23, and DOD-101, page 1, column B, line 1:

Hawaiian Electric Company, Inc.
HECO June and July 2007 Updates
(Thousands of Dollars)
Test Year Ending December 31, 2007

DOD-101
Docket No. 2006-0386
Page 2 of 2

Line No.	Description	Reference	Adjustment Amount (A)	Multiplier (B)	Revenue Requirement Amount (C)
1	Revenue Requirement-per HECO Filing	DOD-101		Pre-Tax Return Difference DOD-105	$ 151,505
2	**Rate of Return Difference on HECO rate base After Pro Forma Working Cash**	**DOD-103**	**$ 1,214,312**	-2.20%	$ (26,715)
3	Subtotal Revenue Requirement				$ 124,790
	Rate Base Adjustments	Sub-Reference:	Reference: DOD-106	Pre-Tax Return DOD-105	
4	HECO June 2007 update	DOD-107	$ (13,100)	13.84%	$ (1,813)
5	Remove Net Pension Asset	DOD-108	$ (36,291)	13.84%	$ (5,023)
6	Cash Working Capital	DOD-109	$ (7,000)	13.84%	$ (969)
7	Accumulated Deferred Income Taxes	DOD-110	$ (8,157)	13.84%	$ (1,129)
8	Subtotal Rate Base Adjustments Before Pro Forma Working Cash		$ (64,548)		$ (8,934)
9	Change in Working Cash at Proposed Rates	DOD-109	$ 956	16.04%	$ 153
10	**Adjusted Rate Base**		**$ 1,150,720**		$ (8,781)
11	Adjusted Net Operating Income - per HECO	DOD-101 DOD-104	$ 24,058		
	Net Operating Income Adjustments	Sub-Reference:	Reference: DOD-111	GRCF DOD-102	
12	HECO June and July 2007 Updates	DOD-112	$ (2,093)	1.797979	$ 3,763
13	Revenues, Known Rate Changes	DOD-113	$ 31,859	1.797979	$ (57,282)
14	Remove Amortization of Pension Asset	DOD-114	$ 3,088	1.797979	$ (5,552)
15	Edison Electric Institute Expense	DOD-115	$ 37	1.797979	$ (67)
16	Security Services Expense	DOD-116	$ 71	1.797979	$ (128)
17	"Community Process" Expenses	DOD-117	$ 202	1.797979	$ (363)
18	Income Taxes - Interest Synchronization	DOD-118	$ 587	1.797979	$ (1,055)
19	Research, Development and Demonstration Exp.	DOD-122	$ 229	1.797979	$ (411)
20	Net Operating Income Adjustments		$ 33,980		$ (61,095)
21	Adjusted Net Operating Income		$ 58,038		
22	Reconciled Revenue Requirement				$ 54,914
23	Unreconciled Difference				$ 45
24	Recommended Revenue Requirement	DOD-101, page 1			$ 54,959

b. See response to part a.

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing DEPARTMENT OF DEFENSE'S RESPONSES TO HAWAIIAN ELECTRIC COMPANY, INC'S. INFORMATION REQUESTS AS TO PENSION ASSET ISSUE were duly served upon the following parties, by personal service, hand-delivery, and/or U.S. mail, postage prepaid, and properly addressed pursuant to HAR sec. 6-61-21(d).

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DATED: Honolulu, Hawaii, September 19, 2007

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